Supreme Court, U. S.
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Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1521

COVINGTON FABRICS CORP., APPELLANT,

versus

SOUTH CAROLINA TAX COMMISSION, APPELLEE

ON APPEAL FROM THE SOUTH CAROLINA SUPREME COURT

MOTION TO DISMISS

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The Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, moves the Court to dismiss the Appeal herein on the grounds (1) that the Appeal does not present a substantial federal question, (2) that the judgment sought to be appealed rests on an adequate nonfederal basis, and (3) that no federal question is presented which has not been previously decided by this Court.

I

THE STATE STATUTES INVOLVED AND THE NATURE OF THE CASE

A. The Statutes

The South Carolina statutes to be considered are Section 65-222.2 of the Code which imposes an apportioned income tax on businesses conducted partly within and partly without South Carolina, Section 65-607 of the Code which imposes an apportioned license tax based on capital stock on businesses conducted partly within and partly without South Carolina and, Sections 65-279.3 through 65-279.6 of the Code which provide a method of apportionment for both income and license tax purposes based on a three-factor formula of property, payroll and sales.

B. The Proceedings Below

This action was brought for the recovery of corporate income taxes and license fees in the Court of Common Pleas, the South Carolina Court of general trial jurisdiction. The Complaint raised two questions; first, that the application of the apportionment formula violated the provisions of Section 65-222.2 of the Code which provides for a reasonable allocation of income and secondly, that the apportionment formula as applied to Covington Fabrics Corp. violated both the Due Process and the Commerce Clauses of the United States Constitution. The Trial Judge referred the matter to a Master for the taking of evidence and instructed him to report his findings of both law and fact. The Master duly reported his findings with the conclusion that the refund should be denied. Exceptions to the Master's Report were taken and heard before the Trial Judge who issued his order in which he affirmed the Master's holdings that the result reached by the apportionment formula did not conflict with Section 65-222.2 of the Code

which requires a reasonable allocation and that the result did not violate the provisions of the United States Constitution. He therefore denied the refund and dismissed the Complaint. Appeal was taken to the South Carolina Supreme Court which affirmed the judgment of the Lower Court. The South Carolina Supreme Court held that the South Carolina taxing statutes as applied were not repugnant to the Constitution of the United States and that the income tax apportionment formula (Sections 65-279.3 through 65-279.6 of the Code) did not produce a result in conflict with Section 65-222.2 of the Code. The Court also stated that Federal Law 86-272 (15 U. S. C. A. 381) requiring certain minimum contacts and activity within a state before its income could be subject to tax was "not relevant" because the evidence did not support the conclusion that Covington Fabrics Corp. was taxable in more than three (3) states.

II

ARGUMENT

A.

The validity of the South Carolina taxing statutes cannot be drawn in question on the ground that they violate a Federal law, i.e., 15 U. S. C. A. 381, because no rights granted under that law have been adjudicated by the South Carolina Supreme Court.

No right of Covington Fabrics Corp. (hereinafter Covington) granted by a Federal law has even been adjudicated by the State Courts, much less rejected. The provisions of 15 U. S. C. A. 381 deny a state the power to impose an income tax when a taxpayer's activities in that state do not exceed certain minimum standards. There is no question that Covington's activities in South Carolina exceeded the minimum standards set by 15 U. S. C. A. 381

and therefore it cannot claim that any rights guaranteed to it under Federal law have been rejected. The Appeal therefore lacks a substantial Federal question and should be dismissed. *Gordon v. Caldeleugh,* 7 U. S. 268, 269 (3 Cranch), 2 L. Ed. 436, 437. The South Carolina Supreme Court did comment on 15 U. S. C. A. 381 but only in deciding a pure question of State law—the apportionment of income taxes and license fees to South Carolina. So long as the result of this apportionment was in conformity with the United States Supreme Court's interpretation of the Constitution (which will be discussed in Argument B), no reason exists why this Court should consider the correctness of a State judgment which did not adjudicate Federal rights. *Herb v. Pitcairn,* 324 U. S. 117, 125; *Murdock v. Memphis,* 20 Wall 590, 636, 22 L. Ed. 429, 444.

The South Carolina apportionment formula attributes sales to this State when a taxpayer ships goods from South Carolina and the taxpayer is "not taxable in the state to which the goods were shipped". In deciding whether the sales factor of the South Carolina apportionment formula (Section 65-279.6 of the South Carolina Code) had been correctly applied to Covington, the South Carolina Supreme Court found the Federal statute (15 U. S. C. A. 381) **not to be revelant** because the evidence supported the conclusion that Covington was taxable in only three (3) states. In those states, Covington was clearly subject to taxation because of its contacts there. In the other states to which goods were shipped, a factual question existed which, in the opinion of the South Carolina Court, should be decided against the taxpayer. The United States Supreme Court has consistently refused to review findings of fact. *Grayson v. Harriss,* 267 U. S. 352, 358; *Fry Roofing Co. v. Wood,* 344 U. S. 157, 160. At the risk of resurrecting such a factual dispute already decided by the State Court, it must be stated that the record does

not support the statement made on behalf of Covington, at page 10 of its Jurisdictional Statement, that its salesmen were regularly engaged in collecting and servicing delinquent accounts in fifty (50) states. On the contrary, the record supports the conclusion that such activity was not the ordinary function of the salesmen and that collections by them were rare. It should be noted that this sparse collection activity was considered of so little consequence that it was not even mentioned in any of the three State Court decisions handed down in this action, i.e., Master's Report, Circuit Court Decision or the Supreme Court Decision. The United States Supreme Court is **not** here being asked to review a State Court decision which held that regular servicing and collection of accounts were insufficient activities to remove the protections of 15 U. S. C. A. 381. There was no such holding by the Courts of South Carolina.

Even if the South Carolina Supreme Court had held that the word "taxable" as used in that State's apportionment formula meant "actually taxed" rather than "subject to tax", no Federal question would be raised. The South Carolina Court was under no compulsion to even consider 15 U. S. C. A. 381. That statute deals strictly with a state's power to tax, it does not affect its historic right to apportion income as it pleases so long as the method does not offend the United States Constitution. This Court has expressly refused to define any specific method of apportionment. See *General Motors Corporation v. District of Columbia,* 380 U. S. 555, 561. The Georgia Courts have considered and rejected the argument that the jurisdictional limitation set by 15 U. S. C. A. 381 should be used in that State's income tax apportionment statute. See *Hawes v. Bonnell,* 156 S. E. (2d) 536, and the recent case of *Blackmon v. Habersham Mills, Inc.,* 212 S. E. (2d) 337. It is clearly a state's right to do so if it so chooses.

The fact that the South Carolina Court was free to consider or not to consider 15 U. S. C. A. 381 shows that no Federal rights of Covington stemming from that law were adjudicated by the State Court. No State statute has therefore been drawn in question as being repugnant to rights granted by 15 U. S. C. A. 381 and the South Carolina Tax Commission therefore respectfully submits that the United States Supreme Court lacks jurisdiction to take this Appeal or to hear the matter on a Petition for *Certiorari.* In the alternative, the Commission requests that this Court restrain from hearing this matter because no substantial Federal question is involved.

B.

The activities of Covington Fabrics Corp. in South Carolina are substantial and sufficient to support the tax in question. No Federal question based on the Due Process Clause or the Commerce Clause of the United States Constitution is presented which has not been previously decided by this Court.

Challenges made in the United States Supreme Court to a state's apportionment of income taxes and license fees on the ground that the apportionment is repugnant to the Due Process Clause and the Commerce Clause of the United States Constitution have been numerous, however, this Court has consistently upheld the apportioned taxes and has stated that the only question with which it is concerned is "whether the state has given anything for which it can ask return". *State of Wisconsin v. J. C. Penney Co.,* 311 U. S. 435. Covington is a unitary business engaged in converting unfinished "greige" textile goods into finished products and selling them throughout the United States. It does no manufacturing and processing or finishing of its products is contracted to independent finishing plants. The activities of Covington in South Carolina are both numerous and substantial. These consist of (1) domestication, (2) importation through the port of Charleston, (3) purchasing unfinished goods from South Carolina wholesalers, (4) contracting with a finishing plant located in South Carolina for the conversion of unfinished goods into finished products and, (5) the operation at McColl, South Carolina, of a centralized warehouse in which it employs between thirty (30) and forty (40) persons and in which Covington stores all of its finished goods inventory.

South Carolina employs the so-called Massachusetts, three-factor, apportionment formula which is based on the average of property, payroll and sales attributable to South Carolina to property, payroll and sales everywhere. A search has revealed no case in which the United States Supreme Court has held the result reached under such a formula to be unconstitutional. A brief review of the United States Supreme Court's prior decisions on the constitutionality of apportionment formulas is convincing that the questions now raised by Covington have been answered by those prior decisions which were followed by the South Carolina Supreme Court in upholding the tax in question. In *Underwood Typewriter Co. v. Chamberlain,* 254 U. S. 113 (1920), this Court upheld an apportionment which allocated 47% of the taxpayer's net income to Connecticut although the taxpayer showed that $1,300,000.00 of its net profits were received in other states and only about $43,-000.00 in Connecticut. This Court sustained an apportionment in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission,* 266 U. S. 271 (1924), which involved a company engaged in brewing ale in England and selling both in that country and the United States. The company contended that the New York Tax Commission was attempting to assign income derived from its operations outside the

United States when it actually operated at a loss in New York. A tax based on $27,537.68 income was sustained on the basis that in-state activities, contributing to the overall unitary income, were sufficient. In *Maxwell v. Kent-Coffey Mfg. Co.,* 168 S. E. 397, North Carolina apportioned 99.2% of the entire net income although the taxpayer established that only .002% of its total sales were "made" within that state. The decision was affirmed by this Court at 291 U. S. 642 (1933), citing the *Underwood Typewriter* case. In *Butler Bros. v. McColgan,* 315 U. S. 501 (1942), the California taxpayer had shown a loss there of $82,851.00; however, this Court upheld a tax based on a profit of $1,149,677.00. Even though accepting Butler Brothers' figures, the Court stated:

> "We agree with the Supreme Court of California that these factors [property, payroll and sales] may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of unitary income', so as to allocate to California its just proportion of the profits earned by appellant from this unitary business."

Because Covington admittedly operates a unitary business and therefore has made no attempt to separately account for its activities in South Carolina, the case of *Hans Rees' Sons, Inc. v. North Carolina,* 283 U. S. 123, the only decision of this Court disapproving of a result reached by an apportionment formula and reversing a State Court decision not to consider evidence relating to separate accounting, is not in issue.

The South Carolina apportionment formula has allocated slightly more than half of Covington's income to South Carolina. This Court has consistently held that precision in apportionment is not required and that a rough approximation is sufficient. *Illinois Central Ry. Co. v. Minnesota,* 309 U. S. 157, 161. New York and California also

levied taxes on its income, however, during the years in question Covington was taxed on only 84% of its income by all states combined. Far from having a complaint that a multiple burden has been placed on it, this taxpayer has not even been taxed on 100% of its income.

It is apparently the sales factor of the South Carolina apportionment formula which Covington believes has burdened it in a constitutional sense. These are sales attributed to South Carolina when shipments were made from South Carolina to other states where the purchasers of the goods were located. However, prior decisions of this Court have held that in the absence of a showing that these sales were used in apportioning income to the state of the purchaser, and it is undisputed here that they were not, there can be no suggestion that interstate commerce has been burdened. See *General Motors Corporation v. Washington,* 377 U. S. 436, citing *Northwestern States Portland Cement Co. v. Minnesota,* 358 U. S. 450. Because no constitutional question is presented which has not been previously decided by the United States Supreme Court, the South Carolina Tax Commission respectfully submits that this Appeal should be dismissed and this Court should decline to review the South Carolina Supreme Court decision which is in conformity with and based on prior decisions of this Court.

CONCLUSION

C.

South Carolina Tax Commission respectfully submits that the appeal herein should be dismissed on the grounds that the judgment of the Supreme Court of South Carolina rests on an adequate, nonfederal basis and that the questions for which review is sought are so unsubstantial as not to need further argument.

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Attorneys for Appellee,
South Carolina Tax Commission.

I hereby acknowledge acceptance of service of Appellee's Motion to Dismiss this .... day of ....., 1975.

JAMES M. WINDHAM,
Counsel for Covington Fabrics Corp.

With the signing of the above acknowledgment of service, I hereby state that all parties required to be served have been served.

JOHN C. von LEHE,
Counsel for South Carolina Tax Commission.